DEPARTMENT OF COMMERCE
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CORE CONCEPT OF

CORPORATE ACCOUNTING

Depreciation

Usually fixed assets are expected to be used for more than one year. Therefore, the depreciable amount of a fixed asset is allocated over its useful life. The amount allocated to a particular accounting period is called depreciation. Thus, depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount of an asset is the cost of an asset less its residual value.

Example

The policy of Akash Ltd. Is to keep company vehicles for 5 years. It has just bought new equipment for Rs. 30000. Today's market price, less selling cost, of a similar equipment that is 5 years old is Rs. 9000, which is a reasonable estimate of the residual value of the new equipment. Calculate

a. Depreciable amount
b. Annual depreciation charge

Solution

a. Depreciable amount   30000 minus 9000 = 21000

b. Annual depreciation   21000/5 years = 4200

Depreciation of revalued asset

In case of revaluation, the depreciation is calculated on the total revalued amount over a period of balance useful lives assessed on the date of revaluation.

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New cost for the purpose of depreciation will be gross cost less accumulated depreciation on the date of revaluation. Along with this, the revaluation reserve is amortised to the income statement based on the useful life of the asset to which it relates. This is done to ensure that depreciation on the revalued amounts shouldn't inflate/ deflate the income statement.

Example:

Shine ltd purchased an asset for Rs. 60000 at the beginning of 2014. It had a useful life of 5 years. On Ist January 2016, the asset was revalued to Rs 75000. The expected useful life has remained unchanged. Show how revaluation is accounted. Also state the treatment for depreciation from 2016 onwards.

Solution

Original cost of the asset on 1-1-2014 =	₹ 60,000
Less : Depreciation for two years (2014 and 2015) (60,000/5 = 12,000 x 2)	24,000
Carrying value on 1-1-2016	36,000

Accumulated depreciation already credited is ₹ 24,000

Revaluation increase (revaluation gain) is ₹ 39,000 (i.e., 75,000 - 36,000 carrying value). The journal entries on 1-1-2016 are :

i)	Asset A/c	Dr. 39,000	
	To Revaluation surplus		39,000
ii)	Accounted depreciation	Dr. 24,000	
	To Asset A/c		24,000
iii)	Accumulated depreciation	Dr. 24,000	
	Asset A/c	Dr. 15,000	
	To Revaluation Surplus		39,000

The depreciation for the next three years will be ₹ 25,000 (i.e., 75,000/3). On the other hand, depreciation on cost is ₹ 12,000 (i.e., 60,000/5). So each year the extra ₹ 13,000 (i.e., 25,000-12,000) can be treated as part of the surplus which has become realised (within next three years the whole amount of surplus ₹ 39,000 can be realised). The journal entry is as follows:

Revluation Surplus	Dr. 13,000	
To Retained earnings		13,000

Note: When a revaluation takes place, the depreciation for the period upto the date of revaluation should be deducted from the carrying value before calculating the revaluation surplus.

Derecognition (Retirements and Disposals)

An asset should be removed from the balance sheet on disposal or when it is withdrawn from use and no future economic benefits are expected from it. The disposal of PPE shall take place in the following two methods: (a) by sale, and (b) by entering into a finance lease. The difference between the sale proceeds and the carrying amount represents the gain or loss on disposal. This should be recognised in the statement of profit and loss (income statement). However, the gain on derecognition shall not be classified as revenue. It is a non-operating gain. Hence it is not taken in the statement of profit and loss.

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